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SUBJECT: DEPUTY SECRETARY KIMMITT,S DECEMBER 3 MEETING WITH
OIL MINISTER SHAHRISTANI

Classified By: CLASSIFIED BY EMIN Ambassador Charles Ries, reasons 1.4
b,d

¶1. (C) Summary: Iraqi Oil Minister Hussein Shahrستاني told Treasury D/S Kimmitt that Prime Minister Maliki and President Talibani have written a joint letter to KRG President Barzani stating that the KRG,s PSA arrangements with foreign companies are unconstitutional until they are reviewed by federal authorities. The letter requests that the contracts be &frozen.⁸ Shahrستاني said the contracts have made it more difficult to get a consensus for the hydrocarbon framework law and isolated the Kurds. Shahrستاني described his ministry,s active discussions with international oil majors and stated that he expects shortly to agree to a series of technical service agreements with them for engineering and enhanced recovery from Iraq,s supergiant oil fields. Shahrستاني also indicated openness to infrastructure investment by majors to be repaid in oil liftings (calculated at the daily index price). Such contracts would not need CoR approval, but Shahrستاني intends to seek endorsement by the Council of Ministers. He planned to meet with senior executives from the companies on the margins of the OPEC meeting December 5 in Abu Dhabi. Shahrستاني recounted ongoing installation of new metering equipment pursuant to a plan designed by BP. Shahrستاني said he intends to secure a foreign partner for the accelerated development of the Akkas gas field in Western Anbar to supply gas to Europe via Syria and the Arab Gas Pipeline. The Europeans are &very keen⁸ to get this gas, and have invited him to Brussels to discuss it.

¶2. (C) Deputy Secretary of the Treasury met in Baghdad December 3 with Minister of Oil Hussein Shahrستاني. D/S Kimmit was accompanied by EMIN, Treasury Attache Smith, and Treasury officer el-Quolaq. Shahrستاني was alone.

Hydrocarbons Framework Law

¶3. (C) Deputy Secretary Kimmitt opened the meeting by raising the hydrocarbons framework law. He commented that as he travels to Europe and Asia looking for support for Iraq and the Compact, the first question many governments ask is why Iraq has not been able to adopt the hydrocarbons law. He said that Under Secretary of State Jeffery would be returning to Iraq shortly to help accelerate work to secure a new law. He asked Minister Shahrستاني to update him on the situation as he saw it.

¶4. (C) Shahrستاني began by noting that formally not much has &changed.⁸ The draft hydrocarbons law is before the Council of Representatives. Tawafuq, Sadrists, Fadila and the Allawi group have all said at various times that they wish to amend the draft law to rule out the possibility of

production sharing agreements (PSA,s). Within the UIA (Shia alliance) there is also sympathy for this view. Thus it will be a complicated matter to get consensus for the bill, which has been made all the more difficult by the KRG,s recent raft of exploration agreements. Prime Minister Maliki has invited KRG President Masoud Barzani to visit Baghdad December 5-6 to discuss hydrocarbons and Peshmerga funding (differences on the latter are holding up the 2008 Budget Law). Shahrستاني said he expected to join the PM,s meetings with Barzani on December 6, after his return from the December 5 OPEC Ministerial.

Maliki-Talibani Letter to Barzani

¶5. (C) The Kurdish exploration and production PSA agreements are obstacles to agreement on the HCL. The Kurds are marketing the notion that opposition to these contracts are a personal issue for him. That is not the case. The issue is constitutional. The determination of the KRG to plow ahead in signing so many PSA,s is causing a strong reaction against the KRG in Baghdad. President Talibani and Prime Minister Maliki recently signed a joint letter to Masoud Barzani stating that what the KRG has done is unconstitutional and strongly requested that the contracts be frozen until they are cleared by the federal government, stating that otherwise there will be consequences. Also, CoR members are very upset. The Kurds are isolated on the issue. In any case, without federal endorsement the contracts are unlikely to be of much value to the investors. There will be no export routes for any oil discovered. The neighboring countries are telling us they will not allow KRG oil exports without federal

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government concurrence.

Federal Government Technical Service Agreements with
International Majors

¶6. (C) At the Deputy Secretary,s request, Shahrستاني described his contacts with major international oil companies. He has appointed a new DG for Licensing and Contracts, whom he described as one of the most able technocrats in the MoO. The new DG held meetings last week in Amman with representatives of major oil companies. The Ministry,s goal is to convert existing memoranda of understanding (providing for gratis training and advisory services from the oil companies to the MoO) into formal reimbursed technical service agreements (TSA,s). Before concluding such agreements, Shahrستاني said senior executives of the major oil companies wanted to meet with him directly (Comment: presumably to gauge his commitment to these relationships). Such meetings have been arranged for the margins of the OPEC Ministerial in Abu Dhabi December 15.

¶7. (C) As he has explained before, Shahrستاني said the TSA,s would provide for engineering, design and procurement

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assistance to the Iraqis in enhancing production from Iraq,s super giant fields, including Rumaylah, Zubayr, Majnoon, and West Qurna. Under these contracts, each one of the majors would partner with the Iraqis for a specific field. Discussions are being held with Exxon-Mobil, Shell, BP, Total, Chevron and Conoco-Phillips. Dedicated teams on the company and MoO sides would share data and design elements by dedicated internet links, CAD/CAM software, etc. (He had previously told Embassy that the companies are reluctant to send their staff to Iraq at present, but would likely do so at a later stage.)

¶8. (C) Shahrستاني said his goal for the investment program was to enable Iraq to increase its production from these existing fields by 1 million b/d in little over a year, depending on access to key items of equipment (custom-built immersible pumps etc.), which at present are difficult to acquire from the saturated equipment market. He said these relationships with the majors are very important to him and that he would be generous in the profit margins accorded in the deals to ensure the companies had an interest in applying their top talent to the projects.

Rising Export Performance and Future Capital Investment Plans

¶9. (C) Asked to comment on volumes, Shahrستاني said the average exports in October were 1.82 mb/d and for November he expected the final number to be about 1.98 mb/d. Many days the MoO is managing to load over 2 mb/d although it cannot sustain this with the approaching winter weather affecting tanker berthing. Overall November production was 2.36 mb/d, of which about 70kb/d went directly as crude to power station fuel. While Iraq's refineries are old and some 50 percent of the output is in the form of heavy fuel oil (HFO), the Council of Ministers recently gave final approval for construction of the MoO's new state-of-the art refinery in Nasariya. This new refinery will process 300 kb/d but because of hydro-cracking it will produce the product equivalent of an older 600 kb/d old refinery. It will take several years to complete this \$5 billion project, but Shahrستاني said he would be signing the project agreements shortly and will be making a first payment of \$128.5 million from the 2007 capital budget. Overall, the ministry has committed \$1.35 billion of its 2007 capital budget and intends to open L/C's for another \$250 million (for imported equipment and services orders) before year-end, making the Ministry's projected total capital investment \$1.6 billion for the year. Shahrستاني said he expected to spend the entire \$2 billion MoF capital budget allocation for 2008.

Oil Majors May Invest in Infrastructure and Get Paid in Oil

¶10. (C) D/S Kimmitt asked if the oil majors would be involved in such infrastructure modernization. Shahrستاني said that several of the international oil companies were keen to invest themselves in infrastructure and get paid in oil liftings. This would be fine with him as long as the accounting is in dollars with pricing based on the index price on the day of delivery. As an inducement, Shahrستاني said he would even be prepared to lock-up additional

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volumes (over and above those needed to pay for the investment) up to 100 kb/d for the benefit of partnering majors.

Iraqi Gas for the European Grid

¶11. (C) Turning to gas, Shahrستاني said that if there is any significant new delay in the hydrocarbons bill, he plans to hold a bid round to get a foreign firm to partner in the development of the Akkas gas field in western Anbar. The Europeans, he said, are very keen to get supplies of dry gas from this Iraqi field into the Arab Gas Pipeline, and so are we. He believes that initial supplies of gas can reach the AGP by the end of 2008 if development is started soon, since it is less than 30 km from the field to the Syrian border (and existing infrastructure). Shahrستاني said that he had been invited to Brussels to discuss the project and will be going soon.

CoR Approvals Needed?

¶12. (C) D/S Kimmitt asked if a field development contract for Akkas, or the service contracts with the majors, would need to be approved by the CoR. Shahrستاني replied that only contracts in the form of PSA,s would need CoR ratification under the current law. The Ministry has full competence to make technical service contracts under existing law, although Shahrستاني said he intends to take them to the Council of Ministers for endorsement, given their significance, even if they don,t exceed the \$50 million threshold. (Comment: The Ministry of Oil is only obliged to take contracts in excess of \$50 million to the CoM for ratification) while most other Ministries have to get approval for all contracts above \$10 million.)

Saddam-Era PSA,s Chinese and Russian

¶13. (C) D/S Kimmitt asked about the existing Saddam-era PSA with a Chinese firm. Shahrستاني explained that together with the Chinese the ministry had completed a review and amendment of the contract to &meet all the conditions in light of the HCL.8 This would ensure that the contract could continue to be implemented if the HCL should pass. At this point however the Chinese firm is considering its options. The PSA is a very old one for a small field named Ahdab and the provisions are not too attractive given current oil prices (e.g., any revenues from oil prices in excess of \$28 bbl goes to the GoI). Shahrستاني explained they are awaiting the Chinese decision but they will give them a deadline since if the Chinese don,t choose to proceed the MoO will do so on its own. The oil deposit is not technically difficult and there is a power plant planned for the area that needs the fuel source to be developed with dispatch.

¶14. (C) As for the Saddam era deal with Lukoil to develop West Qurna Phase II, that contract was annulled by Saddam and never approved by the Parliament anyway, said Shahrستاني. So the MoO,s position is that there is no contract and he has told the Russians they must compete for the field in an open process. The Russians &keep coming back8 to the matter and try to associate it with debt relief. Kimmitt asked if the MoO had relations with other international state-owned oil companies. Shahrستاني said the Ministry has an ongoing memorandum of cooperation and training relationship with the Norwegian firm Statoil. It had had such relations with the Austrian OMV and Indian firm Reliance but recently had suspended these after OMV and Reliance signed improper contracts with the KRG.

Corruption and Metering

¶15. (C) On corruption, Shahrستاني said the ministry had now installed the latest generation of meters on all its ABOT export terminals. (Comment: This was a project funded by IRRF.) These new meters are working well. He said he was also happy with the correspondence with the old meters. The agreement of the two was within tolerances. The ministry has now ordered a set of the new generation meters for the older, smaller KAAOT platform as well as for pipeline pump and gathering stations. As yet however the ministry does not have a complete system of controls from wellhead to export terminal although it is working to build it. The design and

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controlling software was provided by BP, which is also training operators on the software. As soon as all the hardware arrives and is installed, the metering system will be fully operational. Even now, the Ministry,s recorded

export volumes completely agree with the measurements by the lifting oil companies.

¶16. (C) Kimmitt asked whether the opportunities for corruption were more on the domestic product side. Shahrستاني agreed and said we are intensely following this.⁸ The opportunities for corruption based on corrupt individuals are almost over,⁸ he asserted. The biggest problem the ministry faces now are the gangs and insurgents who attack pipelines and trucks to steal crude and product. The main method is to blow up a pipeline. The crude pools in the area. The repair crew comes to repair the pipeline and immediately afterward the gang comes back to collect the crude from the pool. This threat is prevalent in the south, especially in Meysan province. The gathering pipeline from Bazargan field has been hit every week recently, just to steal the oil.

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